



## *Responsibilities of the New York State Insurance Department*

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### ***Background***

Empire Blue Cross and Blue Shield has been responsible for providing hospital and medical coverage to New Yorkers for more than 50 years. At one time, Empire covered more than 9 million subscribers in its 28-county service area, and it was the only insurer that wrote individual comprehensive health insurance coverage through open enrollment.

Today's Empire has changed dramatically. Enrollment is down to 4.5 million subscribers, and with the passage of Governor Pataki's health insurance reforms of 1995, it is no longer the "insurer of last resort." Instead, all health maintenance organizations (HMOs) in the state are required to make available to individuals through open enrollment two comprehensive managed-care products that provide broad coverage for hospitalization, medical care, and prescription drugs.

In 1994, the National Blue Cross/Blue Shield Association (the Association) announced that Blue Cross/Blue Shield plans, which had traditionally been not-for-profit entities, would be allowed for the first time to "convert" to for-profit status. The Association established rules to accomplish these "conversions" that could occur within certain parameters. The converted entity, for instance, would be allowed to keep its Blue Cross/Blue Shield trademark.

It should be recognized that the word "conversion" to describe the transformation of Blue plans from not-for-profit to for-profit

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status has its limitations. This term may, in fact, be inaccurate, since the plans may not strictly change from one kind of insurer to another. Therefore, the term conversion is used herein only for ease of reference. The term itself, in this context, can be a misleading oversimplification of the actual process that takes place.

In August 1996, Empire representatives discussed potential restructuring ideas with representatives from the New York State Department of Insurance (the Department). Meanwhile, the national Association adopted a resolution specific to Empire's restructuring proposal. Then, in November of that year, Empire submitted a broad outline of its proposal to the Department for review of its restructuring to for-profit status. This outline, which is yet to be finalized, involves the transfer of assets and liabilities from Empire, an Article 43 not-for-profit health service corporation, to two for-profit subsidiaries and a charitable foundation. The two subsidiaries are an Insurance Law Article 42 accident-and-health insurer and a Public Health Law Article 44 HMO. The proposal also involves the issuance of stock in an initial public offering (IPO), by which capital would be raised.

Empire's proposal to restructure is in its early stages; by no means has it been finalized. The Department has been proceeding cautiously to evaluate the myriad legal and public policy issues raised. The transformation of a not-for-profit Article 43 insurer to for-profit status has never before been approved in New York State. Moreover, there is no comprehensive statutory framework under which such a transformation could occur.

### ***The Role of the Department of Insurance***

The Department has been meeting periodically with Empire representatives, legislative representatives, and consumer groups interested in the proposed restructuring. The focus of the discussion has been the Department's role as an insurance regulator in evaluating the proposal, and meetings have emphasized preserv-

ing the viability of the health insurance industry in New York State.

### **Analysis of Threshold Issues**

Before approving any aspects of Empire's proposal, the Department has identified several threshold issues that have yet to be addressed adequately. This is not a criticism, rather a recognition that Empire's proposal, which could have significant effects on subscribers, the health insurance market, and the people of the State of New York, must be considered deliberately. A list of these issues will convey the breadth of the matters with which the Department is concerned.

### **The Legal Issues**

- Can the apparent statutory prohibition against a "conversion" to a for-profit entity set forth in Insurance Law §4301 and the absence of a statutory authorization in Insurance Law §7301 be reconciled with Empire's proposal?
- Can portions of the existing law be applied to a situation that was not contemplated when the statutes were originally enacted?
- Does existing law address only isolated self-contained issues, not the broad proposal offered by Empire?
- Must a statutory framework be established by the Legislature before Empire's proposed restructuring can take place?

The Department has been researching the statutory framework enacted in several other states for guidance, should New York decide to enact its own statute. To benefit from the experiences of other states, the Department has also been researching germane litigation that is taking place throughout the country. For example, Missouri has been embroiled in litigation regarding the transformation of one of its Blue plans to for-profit status.

### **The Financial Issues**

- Does Empire currently have sufficient funds to undertake what would surely be a costly restructuring?

- Must Empire undergo a restructuring because it needs access to public capital markets, or are there other financing means that Empire should explore?
- What are the solvency implications of the proposed transformation on the resulting for-profit insurer and HMO?
- What notice or consent is needed from Empire's current subscribers?
- What are the financial implications of Empire establishing a not-for-profit charitable foundation for the resulting for-profit insurer and HMO?
- Will the resulting for-profit insurer and HMO be financially viable, stable, and able to compete in today's market?

The Department notes that if Empire were to propose a cancellation of its existing individual policies, the Department would need to review and approve a 5-month notice of termination to policyholders.

### **The Department as a Regulatory Agency**

*Cooperation with Other Agencies.* The Department has a responsibility to cooperate with other agencies that have interest in Empire's proposal, such as the Health Department and the Attorney General's Office. Although the Department is willing to cooperate, its insurance regulatory concerns may dictate a different approach from that of other agencies. For example, when addressing Empire's current valuation, the Department must emphasize the financial viability of the ongoing insurance company and HMO, whereas the Attorney General will focus on statutory concerns regarding the preservation of Empire's charitable assets.

### **Analysis of Data: Reviews and Determinations**

*Assistance Required by the Department.* The Department will need outside consultants to assist in valuating assets and liabilities to determine if the proposed transformation would result in a viable for-profit insurer and HMO. The Department may need to retain an investment banker, an actuary, an accountant, and a legal consultant. This Department's conclusion regarding the feasibility

**TABLE 1**  
**EMPIRE'S BENEFITS AND OBLIGATIONS BEFORE 1996 HEALTH CARE**  
**REFORM LEGISLATION**

Benefits Provided to Empire	Empire's Obligations
Allowed to pay lower hospital charges than other insurers	Subsidization of Supplemental Medicare insurance
Not subject to premium taxes	Offer provision of coverage to individuals on an open enrollment basis
Allowed flexibility in curing Empire's statutory reserve impairment	
Allowed flexibility in resolving Empire's commitment to the Department to repay monies used to subsidize the start-up of HealthNet HMO	

of the proposal may differ from one adopted by the Attorney General's Office. As indicated, the two agencies have different foci. Primarily, the Attorney General seeks to preserve the charitable asset. The Department, as insurance regulator, primarily seeks to ensure the viability of the resulting for-profit insurer and HMO while protecting Empire's subscribers and preserving the value of the advantages bestowed on Empire by New York State over the years. The Department must determine whether the public interest will be served under Empire's proposal.

*Benefits Received and Obligations Undertaken by Empire.* Specifically, the Department must establish the value of public benefits enjoyed by Empire as an Insurance Law Article 43 non-profit health insurer. After considering the social obligations undertaken by Empire, the Department must also determine if these financial benefits will be "repaid" to the subscribers and the public under the proposed transformation to for-profit status. Table I outlines the benefits enjoyed by Empire as an Article 43 corporation and the obligations it undertakes.

*Costs Associated with Restructuring.* The Department must also review Empire's costs associated with and methods of funding the proposed restructuring, to determine whether this expenditure will cause Empire to exceed the Insurance Law §4309 expense limitation.

## Issues Related to Valuation

The Department must review areas that can affect the valuation process, including the Association's rules, pending litigation, current examination findings, annual compliance audits, adherence to stipulations with the Department, and the effect on the provision of health care in New York State.

*Issues Related to Financial Viability.* Should the proposed restructuring go forward, the Department would view the resulting for-profit insurer and HMO differently than Empire in its current form. The Department would be responsible for protecting the insured public and for assuring the financial solvency of the resulting for-profit organizations. These for-profit organizations would have to support all or most of Empire's current business. The department will weigh many issues, including the following:

- Once Empire's business and liabilities are transferred, the for-profit insurer and HMO will be responsible for premium taxes.
- The for-profit insurer and HMO will have to comply with more stringent risk-based capital requirements.
- As an Insurance Law Article 42 insurer, Empire Health Choice Assurance, Inc. would have to maintain a 4:1 surplus-to-writings ratio.
- As an HMO, Empire Health Choice, Inc. would have to comply with contingent reserve fund and escrow deposit requirements.
- The for-profit insurer and HMO would need to negotiate hospital rates as per the Health Care Reform Act of 1996.
- The for-profit insurer and HMO would no longer be saved by statutory delay in meeting surplus shortages.
- The for-profit insurer and HMO would have to demonstrate that they will have, and be able to maintain, the financial means to support the insurance and managed-care business transferred to them by Empire.

*Economic Impact.* Implementation of Empire's proposal would economically impact the residents of Empire's service areas and the whole state. Issues to be considered include the following:

- How will hospitals, providers and the public in Empire's service area be affected by its restructuring?

- What would be the effect on rates and availability of indemnity contracts?
- What is the value of the Blue Cross trademark to residents of the affected service areas?
- What is the resulting plan of operations for the for-profit insurer and HMO with respect to employment levels, principal location, executive salaries, and stock options?
- What will be the anticipated level of premium taxes?
- Will the resulting for-profit insurer and HMO become targets for an acquisition?

### **Insurance Department Approvals That May Be Required**

*Transfer of Assets to For-profit Organizations.* Certain transfers of assets by a health insurer would be permissible with the approval of the Superintendent, pursuant to Insurance Law §7105. The standards for approval include that the transfer is fair and equitable, does not tend substantially to lessen competition in any line of insurance or tend to create a monopoly, and is not inconsistent with law.

*Holding Company Approval.* A for-profit HMO would need holding company approval from both the Health Department and the Insurance Department for new holding company status. It would also need approval under Insurance Law Article 15 for the formation of a holding company and for any transactions between members of the holding company system and controlled entities.

*Surrender of the Insurance Law Article 43 License.* Pursuant to Insurance Law §1105, Empire would need approval of the Superintendent to surrender its Article 43 license.

*New Officers and Directors.* The Department would review for approval and obtain fingerprints of any new officers and directors of the Insurance Law Article 42 insurer.

*Transfer and Assumption Agreement.* Pursuant to Insurance Law §1308, Empire would need approval of its Transfer and Assumption Agreement.

## ***Conclusions***

When Empire finalizes the restructuring plan, the Department will hold a public hearing regarding Empire's proposal. If the review process proceeds favorably, the Department will ensure that the public has opportunity to provide input on the issues of important public interest that arise from Empire's proposal.